

# RDTOH System

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# RDTOH System

## Overview

Applies only to CCPC

Passive income, Canadian and Foreign, including taxable capital gains and FAPI (if applicable)

Specified investment business (SIB) income

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# SIB

SIB income is income from property including interest, dividends , rents and royalties unless:

- Throughout the year corporation employs more that 5 full time employees in the business, or
- Employed by associated corporation and corporation would reasonably be expected to require more than 5 full time employees itself

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# SIB

More than 5 full time employees means at least 5 full time plus at least 1 part-time

Note throughout the year test

Note “in the business” requirement

Does not apply to leasing property unless real property

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# SIB

Following will be SIB income unless over 5 full time employees throughout the year

Renting land in campground

Interest income of mortgage lender

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# SIB

## Not SIB

Campground where additional services (laundry, swimming pool, playground)

Leasing of equipment, cars, trailers, taxis, taxi licenses (maybe)

Hotel

Property management services

Royalty income derived from own activities/own IP licensed ( see Rocco Gagliese Productions 2018 TCC 136 and CRA document 2019-0798321CG)

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## Recapture

Rental business, over 5 full-time employees

Properties sold part-year. Capital gain. Employees reduced.

Is recapture active or passive

Answer – likely passive

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## Property Management

Rental of real estate. Leases provide for 15% of expenses as management fee to owner.

Profit element to owner from management fee.

Is management fee active?

Good argument yes, up to reasonable profit from this source

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## RDTOH Good or Bad

When system designed in 1972, corporate tax rate on ABI (high rate) about 46%. Major double tax issue without bonus to SBD limit (then \$75,000)

RDTOH allowed double tax to be avoided with dividend refund.

Up to around 2012, dividend refund at 33 1/3%, personal tax at about 34%

No real double tax on payment

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## RDTOH Good or Bad

Over time corporate tax rate/non-RDTOH dropped from 46% to 25% (approx.)

RDTOH rate rose 4% when personal federal rate increase happened

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## RDTOH Good or Bad

But system still reasonable if eligible dividend paid.

	<u>Old Rates</u>	<u>New Rates</u>
Accumulate RDTOH	26 2/3%	30 2/3%
Realize at % of dividend	33 1/3%	38 1/3%
Corporate tax rate	46%	50.12%
Additional personal tax on dividend (tax rate) over dividend refund	1%	1% (eligible) 9% (ineligible)

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## ERDTOH/NERDTOH

To avoid overall tax rate around 58% (top bracket), people streamed eligible dividend to get dividend refund

Then ERDTOH/NERDTOH system brought in to deny small tax advantage.

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## RDTOH Good or Bad

Generally bad

No deferral v personal tax

Higher overall tax by about 4% over top rate when dividend paid out

Lots of situations where integration breaks down

Conclusion. Mostly avoid if you can.

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## Eligible / Ineligible RDTOH

Paying ineligible dividend to get dividend refund

- Refund at 38 $\frac{1}{3}$ % of dividend
  - Personal tax at 47.74% of dividend
- Net cost, around 9.41%

Unless funds needed, favours small tax deferral (but low income using low brackets makes feasible within a range). Need to watch TOSI issues.

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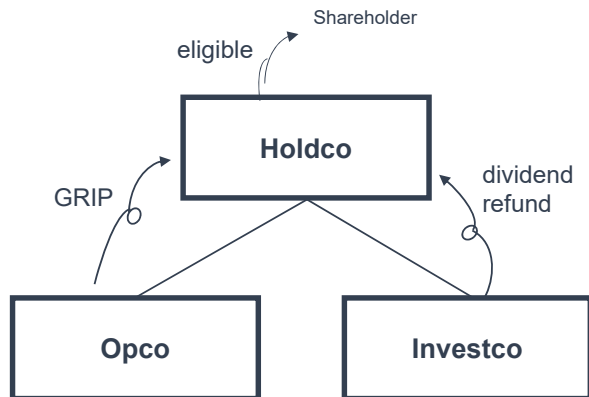


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## Eligible Dividend / Dividend Refund



### NO MIX MATCH ANYMORE

GRIP – eligible refundable dividend tax on hand

Non- eligible dividends paid

- Can refund both eligible ineligible refundable dividend tax on hand

No longer works generally

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## ERDTOH and NERDTOH

Just what we need - More jargon  
- More numbers to track

NERDTOH - Dividend refund only when non-eligible dividend paid

ERDTOH - Dividend refund on taxable dividend paid (eligible or non-eligible)

Existing RDTOH at time of transition (first taxation year ending in 2020) moved to ERDTOH at rate of 38 1/3% of GRIP.

After that ERDTOH pool increases only for Part IV tax on dividends from Canadian public companies, and tracked ERDTOH

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## Where Does RDTOH Break Down

### 1. Foreign Tax Credit

Non-business FTC reduces RDTOH accumulation on 2.59 times FTC. If 15% FTC (e.g. withholding on dividend from US portfolio stock), no RDTOH on \$38.8 out of \$100 dividend. Leads to double tax.

If sale of US real estate, say 25% US tax (federal and state), no RDTOH on taxable capital gain. Blatant double tax.

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## Where Does RDTOH Break Down

### 2. Overpay Dividends

If dividend overpaid, so no dividend refund (on that portion) then double tax. Full personal tax on ineligible dividend, no corporate tax recovery.

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## Where Does RDTOH Break Down

### 3. Loss Carryback

Dividend paid in prior year, dividend refund, everything works.

Later a loss. When loss carried back (capital or non-capital), dividend refund recalculated because RDTOH recalculated. Personal tax on dividend remains.

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## Where Does RDTOH Break Down

### 4. New Issue

No ERDTOH pool and accidentally declare eligible dividend.

No dividend refund even if GRIP, (except 2020 transition ERDTOH if any)

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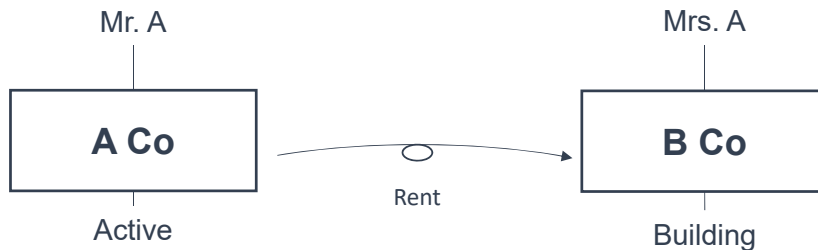
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# Avoiding RDTOH System

## 1. Make Active By Association

If assets used by active business, make companies associated.



Associate A Co and B Co so rent is active

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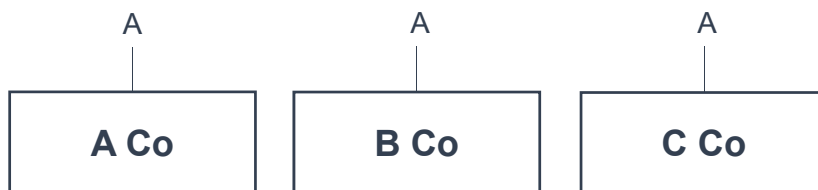
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# Avoiding RDTOH System

## 2. Over 5 Full Time Employees

Hire employees, take activities in house, merge companies



Each corporation has a rental property (1 employee superintendent)  
Merge companies. Hire 2 people for maintenance and part-time  
employee bookkeeper.

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## Avoiding RDTOH System

### 3. Non-CCPC

Change ownership to non-CCPC structure.

Moves to high rate active.

Lower tax overall and deferral

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## Avoiding RDTOH System

### 4. Stay in Low Brackets

At low income/dividend levels RDTOH system still ok (under \$150,000 taxable income).

But watch for TOSI.

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## ABI and RDTOH

If two sources, ABI and RDTOH, and cash required, take from ABI or RDTOH?



Take from RDTOH even if NERDTOH

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## ABI and RDTOH

### Conclusions

Generally want to avoid RDTOH system if possible

Still reasonable on income up to around \$150,000

If 2 sources, take from RDTOH

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